

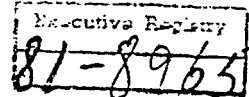
THE WHITE HOUSE

II-90065

WASHINGTON

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SECRET ATTACHMENT~~

December 9, 1981



MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF TREASURY
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE COUNSELLOR TO THE PRESIDENT
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
THE DIRECTOR OF CENTRAL INTELLIGENCE
THE UNITED STATES REPRESENTATIVE TO THE
UNITED NATIONS
THE CHIEF OF STAFF TO THE PRESIDENT
THE DEPUTY CHIEF OF STAFF TO THE PRESIDENT
THE CHAIRMAN, JOINT CHIEFS OF STAFF

SUBJECT: National Security Council Meeting

The President will chair a meeting of the National Security Council in the Cabinet Room of the White House on Thursday, December 10, 1981, from 3:30 to 4:30 p.m. There will be one agenda item:

U. S. Assistance Program for Poland

The paper for the agenda item is attached.

Principals only should attend the meeting.

FOR THE PRESIDENT:

A handwritten signature in dark ink, appearing to read "James W. Nance".

James W. Nance
Acting Assistant to the President
for National Security Affairs

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Review on December 9, 1983

NSC Discussion Paper on Assistance
For Poland

Political and Strategic Setting

The Polish people continue to make significant gains in their ongoing revolution against Soviet-imposed Communist power in Poland. The Jaruzelski regime has been forced to negotiate with Solidarity for a sharing of power. These negotiations, which cover a range of complex political and economic issues, could serve as the foundation on which Polish economic reform and recovery will be built. As the interlocutors work toward a modus vivendi, and the prospects for economic stability begin slowly to improve, the importance of economic assistance to sustain this process becomes more acute.

Strategically, Poland is one of the most important countries in Europe. It occupies a key geographical position, its armed forces comprise 29 percent of the Warsaw Pact's total forces, and it plays a vital role in Warsaw Pact military strategy. The events of the past sixteen months have had a profound impact on Poland. Soviet control in the country has been seriously undermined, and the reliability of the Polish military brought into question. As a result, the Warsaw Pact's ability to carry out an offensive operation against NATO has severely diminished.

It is in the USG interest to institutionalize, or at least prolong this strategic situation. Not only would such a development have a long term impact on the Pact's military potential, it could lead to similar developments elsewhere in Eastern Europe and constrain Moscow's ability to undertake new adventures in other parts of the world. Success of the Polish experiment will cast doubt in the minds of Communist and revolutionary ruling elites about Soviet willingness and capability to sustain them in power. A failure of the Polish experiment, on the other hand, could strengthen the Pact militarily, and encourage the Soviets to crack down elsewhere, thereby enhancing Moscow's control of the region.

Economic stability in Poland is not a guarantee of political stability. A collapse of the Polish economy, however, would certainly lead to political chaos and probably an eventual civil war. It is vitally important that the Polish people get enough to eat -- particularly during this very difficult winter.

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The November 4 meeting between Archbishop Glemp, General Jaruzelski and Solidarity leader Walesa have led to serious negotiations between the government and Solidarity on finding a way to deal with Poland's problems. Although these negotiations may be temporarily interrupted by Solidarity as a result of its resentment over the forcible removal of the striking firefighting cadets from their school on December 2, pressures on both sides will probably lead to an early resumption of talks. In this setting, Walesa himself has spoken to us of the importance of Western aid. He has told Ambassador Meehan that Solidarity's ability to secure U.S. aid could decisively affect the outcome of current negotiations over the reform of the Polish economy and the redistribution of political power.

Economic Situation

Poland's economic situation is extremely serious and continues to deteriorate rapidly. Domestically, Poland is facing the combined problems of declining production and soaring inflation. The zloty has lost a substantial amount of its purchasing power and, since there are few goods available for purchase in any case, workers have little incentive to work. Domestic production and national income are projected to decline by 13 and 15 percent respectively during 1981, largely due to shortages of raw materials and imported inputs.

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Poland's external position is equally grave. At this late date, Poland still lacks some \$800 million to close its 1981 external financing gap, of which roughly \$500 million is owed to banks under the terms of the private sector debt rescheduling agreement due to be signed on December 10, 1981. The inability of the Poles to generate these funds, and the expressed position of Western governments that they will not provide financing for this purpose, calls into question the outcome of Poland's negotiations with the private banks and raises the possibility of a formal declaration of Polish default.

In 1982, Polish needs could range as high as \$9.4 billion. Even with additional official and private debt relief and other financial arrangements the Poles say are in place, the residual requirement for new credits is \$3.5 billion. The Poles are looking to the West for all of these

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credits, and have specifically requested that the U.S. provide \$740 million, of which \$200 million was requested on an urgent basis. This is comparable with the amounts of U.S. agricultural commodities the Poles have purchased commercially in recent years.

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One cannot predict with certainty the size of Polish financial needs in 1983. In large part, these will be determined by the levels of assistance Poland receives in 1982, and by the extent to which the Poles are able to implement their reform package. In any case, however, Polish needs are likely to remain on the same order of magnitude in 1983, leading to a continued need for debt relief and additional financial assistance. Over the next three to five years, Poland's projected level of hard currency debt service and the anticipated level of imports which will be required to rebuild the Polish economy will generate a substantial need for hard currency. The extent to which Poland will be able to meet these demands through increased export earnings depends on how effectively they can implement the economic reforms designed to promote exports. Agricultural reform with an emphasis on the private sector would lessen Poland's food import requirements and will also be a key factor in improving Poland's external financial position over the next three to five years. Nonetheless, Poland will most likely require assistance throughout this period.

U.S.-Western Response

Against this political and economic backdrop, the U.S. and our Western allies must formulate a response. The State Department proposes to request Presidential authority to:

1. provide an immediate \$100 million in emergency assistance, primarily feed grains to stave off distress slaughter of Polish livestock and poultry; and
2. begin consultations with our allies on a medium-term, multilateral assistance program for Poland, to which the U.S. contribution would range from 15 to 25 percent of the total Western contribution. This implies an upper limit of \$740 million in CY 1982.

A copy of the memorandum describing these requests is attached.

In each case, we will do what we can to assure that Solidarity, rather than the Polish government, receives credit for our actions. In particular, Solidarity visits to the U.S. will be used for this purpose.

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Emergency Assistance

The CCEA has endorsed the proposal for providing \$100 million in emergency assistance to Poland. Given the basic interagency agreement achieved on this issue and the pressure of time, it would seem best for the CCEA to work out the technical details of the package, based on a Presidential authorization. There are two possible sources of funds for this package which do not require new legislation or additional budgetary authority. The possibility which both State and USDA support is a CCC sale of surplus stocks of corn on a long-term dollar credit.

The alternative would be to tap PL-480 and/or Economic Support Fund (ESF) programs for \$100 million. However, this option poses difficult and time-consuming foreign policy trade-offs. Over half of the \$100 million PL-480 reserve is already spoken for and the needs of other claimants far outstrip available funds. Reprogramming for Poland would preclude us from responding to all of these needs. Tapping ESF funds is also difficult, and under current funding levels, would require reprogramming from other high priority recipients (Israel, Egypt, the base/transit right countries). Even with the additional funds requested, some crowding out could occur. In view of these constraints, State and USDA believe that the sale of CCC-held corn is the better course of action if we are to move quickly.

The issue of cargo preference is of critical importance. Unless the Administration waives strict compliance with applicable regulations, the additional costs may place the corn out of the Poles' reach financially. Such a waiver is possible. In addition, it should be recognized that the emergency assistance effort will have to be channelled through the Polish government rather than private voluntary agencies. However, since Solidarity has requested this and will monitor distribution, we can still emphasize Solidarity's role in the process.

The Medium-Term Program

State has requested that the President authorize consultations with our allies on a multilateral assistance program over the medium term. No commitment of funds is sought at this time. Nonetheless, the possibility that the

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USG may eventually participate in a medium-term assistance effort raises a number of fundamental questions:

- What will the U.S. (and the West) receive in return for this substantial outlay of funds? Assistance to Poland at this point offers a real possibility of preserving the political liberalization process which has gathered momentum in recent weeks. This can result in substantial strategic gains for the U.S. by weakening Soviet hegemony in Eastern Europe and limiting Soviet activities elsewhere. By using assistance to support political liberalization accompanied by economic reform, the West will also be fostering the creation of a more pluralistic society. The goal is a viable Poland, closely linked to Western institutions. This offers the hope that Western banks and governments will be repaid.
- Will we ever see an end to the Polish economic problem and the need for continued U.S. assistance? While Polish economic problems are extremely grave, the Poles have the basic ingredients (e.g. a resource and industrial base and a trained work force) for eventual economic recovery. The basic problem in Poland has been its economic policies, as formulated by a series of Communist regimes. U.S. aid is not going to prop up this type of regime. On the contrary, U.S. aid is going to meet humanitarian concerns and assist popular democratic forces in Poland striving for independence from Soviet domination. U.S. aid would only be granted on the condition of Polish progress on economic reform and the continuation of the political liberalization process. Solidarity leader Walesa has appealed for U.S. aid and we will insist upon Solidarity consent and monitoring of our assistance to promote its effective use. Poland has already applied for IMF membership. The expert economic advice of the Fund, and the eventual economic resources it may provide, can help assure Polish adherence to a credible economic reform package.
- Will aid from Western governments merely serve to "bail out" Western private banks? The final answer to this question will depend on the outcome of Polish/private bank negotiations which will follow the expected failure of Poland to meet the payment of interest and fees due on December 10. In the extreme, the banks could formally declare Poland in default. If so,

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Western aid to Poland would not be passed on to the banks, but as banks write off their Polish losses, all Western governments would experience losses in tax revenues and some (e.g. Germany) might become involved directly in supporting their banks. In the best case, the private banks would be brought to an agreement which resulted in no net withdrawal of funds from Poland. Achieving this goal will depend primarily on Polish negotiating efforts with the banks and, to some extent, on the lead Western governments, by their own actions, give their banks. Western government support of Poland may induce the banks to continue their efforts to reach accommodation with the Poles. No doubt the banks are hoping to be bailed out. Western assistance must be structured to prevent this.

- Where will we obtain funds for such a large-scale program? The emergency assistance of \$100 million will be sought through channels which do not require additional legislation and/or budgetary outlays. For a medium-term program of larger size, we will face difficult choices. One option would be to reallocate these funds from existing budgetary resources. Obtaining funds of the magnitude contemplated would not be possible by tapping other Foreign Affairs line items without making substantial cuts in high priority programs (Egypt, Israel, Turkey). Our only other option is to seek supplemental budgetary authority, a very difficult step in view of the Administration's stance on the budget. Some of Poland's CY 1982 assistance needs could possibly be deferred for funding under FY '83 budget programs. However, the timing of Poland's needs for agricultural products will require that much of the funding be carried out in FY '82.
- What are the prospects for continued Soviet sharing of the burden of assisting Poland? The USSR has demonstrated its interest in preventing a complete economic collapse in Poland, which could precipitate political and social conditions requiring them to invade, a step they have chosen to avoid. In 1981, the Soviets provided roughly \$2.5 billion in hard currency assistance to Poland, an amount which equals the total Western package we contemplate for 1982. The Soviets have already rescheduled Polish hard currency payments falling due in 1982. The Poles have stated that no new hard currency assistance will be available from

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the Soviets next year. Continued Polish trade deficits vis-a-vis the USSR are projected. However, the Soviets will make their judgments on continued assistance on a political/military basis and could reduce it if Western assistance efforts are seen as producing unacceptable political change. In this regard, recent Soviet acquiescence to Polish and Hungarian IMF membership applications may indicate a more pragmatic Soviet attitude related at least in part to their fears of assuming a further economic burden in Eastern Europe. *Sy. volm?*

- What are the prospects of achieving an acceptable burdensharing arrangement with our Western allies?
Our allies all face tight budgetary constraints similar to ours. It is clear that none of them is willing to make a substantial outlay of funds for Poland without first assuring broad multilateral burdensharing. We do not know how far they are prepared to go at present, and without U.S. leadership it will be difficult to obtain an answer.. More importantly, the U.S. must also make clear to our allies that an equitable burdensharing arrangement with full participation by other Western donors is a sine qua non for U.S. contribution to the medium-term effort.
- Can the West effectively impose sufficient conditionality on its assistance to assure an effective reform program in Poland? Although the responsibility of implementing a comprehensive economic reform program rests primarily on the Poles themselves, Western creditors must promote this process by requiring and expanding upon the conditionality associated with their debt relief and assistance measures. Polish efforts date from April, 1981, and measures taken since then have not yet been fully implemented due to divisions within the Party and government. The comprehensive Polish reform package was not expected to be introduced until January, 1982. Recent reporting now indicates that implementation may be delayed. It is hoped that the increased dialogue between the Party, Church and Solidarity will allow the Poles to form the social compact essential for progress.
- What are the political and economic costs of failing to assist Poland? Without further Western assistance, the Polish economy will decline into chaos, providing conditions which could lead to either a Soviet invasion or an internal crack-down by the Polish Party. In either case, Polish forces of liberalization will

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be discredited. For the West, the political and strategic losses will be substantial: the Soviets will regain control of the region, strengthening Pact defenses and encouraging Soviet repression elsewhere. The West will be discredited as having failed to respond to Solidarity's plea for assistance. Economically, Western governments will be faced with the consequences of a Polish default, e.g. the loss of revenues associated with the tax write-off of banks' exposure to Poland as well as nonpayment on government debt. A large influx of Polish refugees could also result in additional budgetary expenditures for the U.S. and other Western nations. If Polish economic collapse were to result in a Soviet invasion and the U.S. imposed a grain embargo in response, the U.S. agricultural industry would incur substantial economic losses. Finally, default in Poland could interrupt the normal functioning of international financial markets.

Both the stakes and the risks are high. Moreover, our opportunity for action may be short-lived. Unless the U.S. and other Western donors act quickly, continued economic deterioration in Poland could reach the point of no return, endangering the country's stability and all the gains of democratic forces in Poland.

Checklist of Decisions

1. That the President endorse our efforts to implement quickly the CCEA decision to provide a \$100 million emergency assistance program for Poland. A sale of CCC-held corn financed by long-term credits is the preferred option of State and USDA.

2. That the President authorize the Department of State to begin consultations with our allies on a \$2 - 2.5 billion multilateral assistance package, of which we would expect the U.S. contribution for Poland to be between 15 and 25 percent. Such a U.S. contribution, of which the \$100 million in emergency food assistance should form a part, would enable us to meet substantially the recent Polish request to purchase \$740 million in agricultural commodities.

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